

# **COMMONWEALTH GRANTS COMMISSION**

**Report on  
General Revenue Grant Relativities  
2000 Update**

# **COMMONWEALTH GRANTS COMMISSION**

## **REPORT ON GENERAL REVENUE GRANT RELATIVITIES 2000 UPDATE**

**CANBERRA**

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### **The Report**

A volume of Supporting Information accompanies this Report.

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The Hon. John Fahey MP  
Minister for Finance and Administration  
Parliament House  
CANBERRA ACT 2600

Dear Minister

As members of the Commonwealth Grants Commission appointed under the *Commonwealth Grants Commission Act 1973*, we respond in this report to the terms of reference received in your letter dated 5 December 1999.

In accordance with the terms of reference, the results of the update were provided to the States and Territories on 18 February 2000.

Yours sincerely

A G Morris, Chairman

K W Wiltshire, AO, Member

L J Early PSM, Member

H A Rolfe, Member

R J Searle, Secretary  
28 February 2000

## **ACKNOWLEDGEMENTS**

We are grateful for the ready co-operation extended to the Commission and its staff during this inquiry by Commonwealth and State Treasury officers and by staff of the Australian Bureau of Statistics.

We also acknowledge the dedication and professionalism shown by the staff of the Commission during the period of the inquiry.



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## TERMS OF REFERENCE

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### MINISTER FOR FINANCE AND ADMINISTRATION

Mr Alan Morris  
Chairman  
Commonwealth Grants Commission  
Cypress Court  
5 Torrens Street  
BRADDON ACT 2612

5 December 1999

Dear Mr Morris

I am writing to provide you with terms of reference for the Commonwealth Grants Commission to update the per capita relativities used to distribute GST revenue and health care grants to the States and Territories in 2000-01.

The terms of the reference are as follows:

1. Pursuant to sections 16, 16A and 16AA of the *Commonwealth Grants Commission Act 1973*, I hereby refer to the Commission for inquiry into and report upon, by 25 February 2000 at the latest, per capita relativities for use in distributing a combined pool of GST revenue grants and health care grants among the States, the Northern Territory and the Australian Capital Territory in 2000-01. Notwithstanding the above, the Commission should ensure that the per capita relativities are provided to the Commonwealth, States and Territories by 18 February 2000.
2. The Commission's assessments should be based on the review period covering the years 1994-95 to 1998-99 inclusive.
3. The Commission's assessments should take into account the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* which was signed by Heads of Government in June 1999. In deciding changes to methodology which the Commission considers appropriate to fulfil this requirement, the Commission should consult the Commonwealth and the States.
4. With the exception of changes to methodology which the Commission considers are appropriate to fulfil the requirements of paragraph 3 above, the Commission's assessments should be based on the application of:

## *Terms of Reference*

- (a) the same principles;
- (b) the same items of revenue and government services;
- (c) for each of those items, the same method of assessment and the same range and methods of measuring expenditure and revenue disabilities; and
- (d) the same range of Commonwealth revenue payments and, for each of those payments, the same method of treatment.

as it used to calculate the per capita relativities provided in its Report on General Revenue Grant Relativities 1999 (the 1999 Report). Where it is necessary to accommodate later budget developments, the Commission's assessment should be based on the principles, methods of measuring revenue and expenditure disabilities and methods of treating Commonwealth revenue payments that conform to those applied in similar circumstances in the 1999 Report.

5. The Commission should prepare its assessments on a basis consistent with the Commonwealth's intention that the distribution of GST revenue grants and health care grants should not be affected by loans, payments or repayments to the States, the Northern Territory and the Australian Capital Territory under clause C1 of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations.

6. A separate assessment should be made of the transitional allowances and special fiscal needs required by the Australian Capital Territory.

7. The Commission should provide, in addition to per capita relativities incorporating the approach outlined in paragraphs 1 to 6 above, a set of per capita relativities for use in calculating the distribution of a combined pool of financial assistance grants and health care grants which would have resulted from a continuation of the Commonwealth-State financial arrangements which applied in 1999-2000.'

The States and Territories, and the Australian Statistician, have agreed to provide to the Commission, as far as is practicable, all relevant information required for this update in a timely manner.

To the extent possible, the Commission should, upon reporting, provide all parties with details underpinning its calculations and assessments, and endeavour to meet requests for supplementary calculations.

Yours sincerely

JOHN FAHEY

# CHAPTER 1

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## THE CONTEXT FOR THE UPDATE

1. The main role of the Commonwealth Grants Commission is to advise governments on 'per capita relativities' — the measures of relative need used to distribute among the States the general revenue grants made available each year by the Commonwealth. The relativities are recalculated annually and are based on an assessment period of five years. The methods used are reviewed every five years, the last review having been completed in February 1999. Between reviews, the annual updates are based on the data for the latest available five years.

2. This update, for which the Commission received terms of reference from the Minister for Finance and Administration on 5 December 1999, uses data for the years 1994-95 to 1998-99.

3. The relativities calculated in this update will be only a comparatively minor element in the determination of the Commonwealth grants to the States in 2000-01. The implementation of the 1999 *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (the IGA), which the Commonwealth and the States signed in June 1999, will have a much larger influence.

4. This chapter presents:

- (i) the requirements of the terms of reference for the update, including the requirements relating to the agreed tax reform measures; and
- (ii) a brief explanation of the work of the Commission and how the update has been conducted.

## THE TERMS OF REFERENCE

5. The terms of reference included at the front of this report require us to report, by 25 February 2000, on per capita relativities for use in distributing grants among the States in 2000-01.

6. Two sets of per capita relativities are required. They are:
  - (i) relativities for distributing the combined pool of Goods and Services Tax (GST) revenue and health care grants<sup>1</sup> (clause 1); and
  - (ii) relativities for distributing the combined pool of financial assistance grants (FAGs) and health care grants<sup>2</sup> which would have resulted from a continuation of the Commonwealth-State financial arrangements that applied in 1999-2000 (clause 7).

7. In this report, we refer to the first set as the **GST relativities** because they are to be applied to the GST revenue. They are also based on a different scope of expenditures and revenues than the 1999 Review relativities. Chapter 2 and Chapter 4 discuss their calculation. We refer to the second set as the **FAG relativities** because they are to be applied to a pool equivalent to an estimate of what the financial assistance grants would have been if they had continued. These relativities are calculated on the same basis as the 1999 Review relativities. Chapter 5 discusses their calculation.

8. Both sets of relativities are calculated using the same principles and methods for assessing standardised revenues and expenditures as those used in the 1999 Review, except where changes were necessary for the calculation of the GST relativities and to accommodate budget developments. As required by the terms of reference, such changes are consistent with the principles and methods used in the 1999 Review.

9. The terms of reference give prominence to the GST relativities because, as a result of the tax reform arrangements set out in the *A New Tax System* (ANTS) package, the pool of general revenue assistance to which these relativities apply will, in future, comprise GST revenues.

10. In addition, we are required to provide a separate assessment of the transitional allowances and special fiscal needs of the ACT. This is provided in Chapter 6.

## THE WORK OF THE COMMISSION

11. The role of the Commission is to calculate per capita relativities that can be used by the Commonwealth to distribute general revenue assistance to the States. The Commission's calculations are based on the principle of fiscal equalisation, which is that:

State governments should receive funding from the Commonwealth such that, if each made the same effort to raise revenue from its own sources and

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1 In this report, this combined pool is referred to as the GST pool.

2 In this report, this combined pool is referred to as the FAG pool.

operated at the same level of efficiency, each would have the capacity to provide services at the same standard<sup>3</sup>.

12. Box 1-1 explains how the relativities are used.

**Box 1-1: How the Commission's Relativities are Used**

As noted, the per capita relativities calculated by the Commission are used to distribute general revenue assistance to the States. Commonwealth Treasury applies the Commission's per capita relativities to population estimates provided by the ABS to calculate weighted populations. A State's share of weighted population is calculated by dividing its weighted population by the Australian weighted population. A State receives a share of the general revenue assistance equal to its share of weighted population. The following table reproduces the calculation from *Federal Financial Relations 1999-2000, Budget Paper No 3*.

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Estimated population <sup>(a)</sup> '000	6446.6	4736.9	3537.3	1879.5	1499.0	470.0	310.7	194.9	19074.9
Per capita relativities <sup>(b)</sup>	0.89948	0.86184	1.00687	0.94793	1.20680	1.60905	1.10270	4.84429	na
Weighted populations <sup>(c)</sup> '000	5798.6	4082.4	3561.6	1781.6	1809.0	756.3	342.6	944.0	19076.1
Share of weighted population (%) <sup>(d)</sup>	30.4	21.4	18.7	9.3	9.5	4.0	1.8	4.9	100.0
Amount of general revenue assistance <sup>(e)</sup> \$m	6974.2	4910.1	4283.7	2142.9	2175.8	909.6	412.1	1135.3	22943.7

- (a) Projected populations as at 31 December 1999, prepared by ABS.
  - (b) The per capita relativities for 1999-2000 as adopted at the 1999 Premiers' Conference.
  - (c) The product of the first and second rows.
  - (d) State weighted population as a percentage of total Australian weighted population. Although shown to one decimal place, unrounded percentages are used in the ensuing calculation.
  - (e) The application of each State's unrounded share of weighted populations to the pool of \$22 943.7 million.
- Source: *Federal Financial Relations 1999-2000, Budget Paper No. 3, Table 12, p30.*

13. The application of this principle results in general revenue assistance being distributed unevenly, in per capita terms, because the relativities reflect differences, beyond the States' control, in:

- per capita expenditure required to provide average levels of service;
- per capita capacities to raise revenue from State sources at average rates of tax; and
- per capita shares of Commonwealth specific purpose payments (SPPs).

3 Commonwealth Grants Commission, *Report on General Revenue Grant Relativities 1999, Volume 1, Main Report*, p4.

14. The Commission's methods for calculating revenue capacities and costs of service provision were decided during the 1999 Review<sup>4</sup> and are summarised briefly below.

## THE EQUALISATION PROCESS

15. The starting point for the Commission's work is the development of financial standards against which the revenues and expenditures of each State can be compared. These **financial standards**, which are the national average per capita expenditure or revenue for each function, are derived from State accounting records. An expenditure or revenue standard is obtained by classifying comparable State financial transactions together in a category.

16. The **standard budget** is the collection of all the expenditure and revenue categories and includes all the recurrent financial transactions of the States.

17. The next phase of the process is to calculate:

- (i) for each State service, the per capita expenditure each State requires to provide the average level of that service; and
- (ii) for each source of State revenue, the per capita capacity of each State to raise revenue from that source at Australian average rates.

18. The assessments are, as far as possible, policy neutral — a State's policy decisions should not influence its grant. A common or average State policy on each function is derived from States' actual practices. Policies of an individual State are within the control of its government and so are not taken into account in determining its grant. If a single State introduced a new tax (or extended a common tax into a new area), the Commission would treat the new tax as a State policy decision. While the revenue from the new tax would be included in the standard budget (because all transactions are included), the Commission would not assess any State as having a capacity to raise revenue from the new tax.

19. **Expenditure assessment** methods take account of the influences that require a State to spend more (or less) per capita than others to provide the same service (described as its cost of service provision). These influences generally relate to characteristics of State populations or the physical and economic environment, and are measured relative to the Australian average characteristic.

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4 *Ibid*, Chapter 3.

20. Some examples of influences taken into account in State expenditure assessments are:

- (i) the size of the group for whom the service is provided — for example, a higher proportion of population of school age, compared to the national average, results in a relatively greater demand for school services;
- (ii) the needs of specific groups such as indigenous or non-English speaking background people — for example, a higher proportion of indigenous Australians, compared to the national average, leads to a relatively higher cost of delivering health services; and
- (iii) the cost of living in remote areas — a higher proportion of the population living in remote areas, compared to the national average, leads to relatively greater costs of service delivery due to such expenses as communication and freight.

21. **Revenue assessment** methods take account of the influences beyond a State's control that enable it to raise more (or less) revenue per capita than other States (its revenue raising capacity). Measures of States' taxable capacities are either legislative bases, estimates of the relative size of the economic resource that is being taxed or other economic indicators that are seen as proxies for the tax base.

22. Some examples of influences taken into account in revenue assessments are indicators of economic activity, such as wages and salaries, industrial/commercial land values and land sale transactions generally; Gross State Product; and Household Disposal Income; all of which can be useful to indicate differences in capacity to raise revenues.

23. Some functions are not assessed differentially between the States because the Commission judges that there is no relative advantage or disadvantage (disability) between States, or there is a disability that cannot be adequately measured or should not be measured because it would not have a material effect on equalisation. In these cases, the cost of providing services or revenue capacity is assessed to be equal per capita (EPC) across Australia.

24. The final phase of the equalisation process is to **calculate per capita relativities**. Each State's relativity factor is its per capita requirement for general revenue assistance relative to the Australian average. A State's per capita requirement for general revenue assistance is equal to:

- an equal per capita share of the total general revenue grants;
- plus* an adjustment for the effect of assessed influences on costs of providing services;
- plus* an adjustment for the effect of assessed influences on revenue capacities;

*plus* an adjustment for the specific purpose payments (SPPs) available to fund a States' expenditure requirements<sup>5</sup> (essentially, the Australian average per capita specific purpose payments, less the per capita amount received by the State).<sup>6</sup>

## CHANGING THE 1999 REVIEW METHODS

25. In general terms, the expenditure and revenue methods the Commission is to apply until the 2004 Review were determined in the 1999 Review. However, the States have agreed that the Commission might, under specified circumstances or as directed in its terms of reference, make minor changes to assessments during updates.

26. Clause 3 of the Terms of Reference for this update directed us to make the changes necessary to assess relativities for GST revenue grants, and clause 4 required us to use the same principles and assess the same items as in the Commission's *Report on General Revenue Grant Relativities 1999*. We were therefore subject to Update Guidelines<sup>7</sup> under which, given the Commission's normal consultative procedures, minor changes might be made to assessments to:

- (i) incorporate the latest available figures for financial and other data in series presently used in assessments;
- (ii) take account of major changes in Commonwealth-State financial relations, including functions transferred up to the commencement of the application period, and of major new or changed SPPs;
- (iii) accommodate other budget developments;
- (iv) amend assessment methods (for example, by using estimates) where data previously used are no longer available;
- (v) apply new or better data not previously considered; and
- (vi) correct errors in calculations.

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5 A description of the Commission's treatment of specific purpose payments is provided in the volume of *Supporting Information* associated with this report.

6 Each of these adjustments may have negative or positive values.

7 Commonwealth Grants Commission, *Report on General Revenue Grant Relativities 1999, Volume 1, Main Report*, p79.

## **CHANGES IN THIS UPDATE**

27. The Commission calculates per capita relativities as a moving average of five years of data. For the 1999 Review, the Commission used data for the years 1993-94 to 1997-98. The terms of reference for this update ask the Commission to base its assessments on the years 1994-95 to 1998-99. Therefore, we have removed the 1993-94 assessments made in the 1999 Review and replaced them with 1998-99 assessments.

28. We have also revised data for the years 1994-95 to 1997-98, consistent with the requirements of the terms of reference that the latest available data should be used.

29. The Commission also made the changes required as a result of the IGA (and by the terms of reference) and a number of other small changes allowed under the update guidelines. Chapter 2 sets out the major developments that arose in this inquiry and how the Commission dealt with them.

30. Chapter 3 presents the results and Chapters 4 and 5 discuss the changes from the relativities that were assessed in the 1999 Review.

### ***Procedures for the Conduct of the Update***

31. Work on the update commenced in July 1999 in anticipation of the terms of reference. Requests for information to update data to 1998-99 were sent to the States in August and arrangements were made to obtain other data for the calculations, mainly from the Australian Bureau of Statistics (ABS), as soon as they became available.

32. In September 1999, a discussion paper<sup>8</sup> was distributed to the parties for comment and further correspondence took place following the receipt of State submissions (see Attachment B in the volume of *Supporting Information* accompanying this report). The matters discussed with the States covered proposals for:

- (i) dealing with new or changed Commonwealth-State financial arrangements — mainly the arrangements under the IGA;
- (ii) preparing the standard budget; and
- (iii) other assessment issues.

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<sup>8</sup> Discussion Paper CGC 99/2, *Proposals for the Treatment of New Developments in State and Territory Finances, and Data Changes Relevant to the 2000 Update of Relativities*, September 1999.

## CHAPTER 2

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### NEW DEVELOPMENTS

1. Some important new issues arose in this update. They were:
  - (i) the use of estimation procedures to assist in determining the standard budget;
  - (ii) the treatment of abnormally large superannuation payments in 1998-99; and
  - (iii) the changes to the 1999 Review methods that were required to produce the GST relativities.

2. This chapter discusses these issues and provides background on how the tax reforms and the Intergovernmental Agreement (IGA) have affected the work of the Commission. Background material and a discussion of developments of lesser impact can be found in the volume of *Supporting Information* which accompanies this report.

### COMPILING THE STANDARD BUDGET

3. By agreement with the States, the Commission has, in recent years, derived its standard budget from financial data States provide to the ABS under the Government Finance Statistics (GFS) arrangements. The ABS, the Commonwealth and the States agreed that 1998-99 GFS data would, for the first time, be on an accrual basis. In the event, the compilation of reliable and comparable accrual data proved extremely problematic for the States and the ABS. Other than for the ACT, the GFS data needed for this update were not available, and we had to estimate 1998-99 expenditures on a cash basis for all States.

4. In developing estimation procedures, we sought comments from the States on the method to be applied, and advised them of our preliminary estimates for each assessment category.

#### *The 1998-99 Standard Budget Procedures*

5. *Commonwealth general revenue and specific purpose payments.* The Commonwealth general revenue and specific purpose payments to the States are based on

data published in the *Commonwealth Final Budget Outcome 1998-99*, supplemented by data requested from Commonwealth agencies — the same procedures as used in earlier years.

6. ***State own-source revenues.*** Apart from the ACT, the Commission had no final data and was obliged to estimate State taxation and other revenue. This involved the analysis of the latest data published by the States. In some cases, the data were from Financial Statements and, in others, from 1999-2000 budget documentation. In several cases, aggregated data were disaggregated in the same proportion as the corresponding 1997-98 figures.

7. ***State expenditures and user charges.*** The Commission could not readily estimate category standards from the available published State expenditure data, because the level of detail needed for the analysis was not available. In estimating expenditure and user charges for each category and for each State, we adopted a conservative approach and:

- (i) calculated an annualised growth factor (increase or decrease) for each expenditure and user charge category using standard budget data for the years 1994-95 to 1997-98;
  - capped the growth factor at  $\pm 10$  per cent; and
  - if the data did not permit calculation of a growth factor <sup>1</sup>, the expenditure or user charge revenue was assumed to continue at its 1997-98 level;
- (ii) applied the growth factors to the State's 1997-98 own-funded expenditure<sup>2</sup> and user charge revenue; and
- (iii) for expenditure categories, added back any 1998-99 Commonwealth (SPP) financed expenditure to the estimate calculated in (ii).

8. The Commission undertook some sensitivity testing of the implications of its method of estimation of expenditures by comparing the results of those procedures for the ACT with actual data. For the ACT, the Commission's estimates of State expenditures understated actual expenditures by about two per cent. If our estimates for all States were increased by two per cent, the additional redistribution would be less than \$7 million.

9. The Commission also measured the impact on States' grants of different estimation procedures (for example, by varying the  $\pm 10$  per cent cap). The changes in redistribution were small enough to confirm that the estimation procedure was acceptable in the current circumstances.

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1 In some cases a concessions category was a net revenue in one year but a net expenditure in another.

2 That is, net of any Commonwealth funded expenditure (SPPs).

***Treatment of 1998-99 Data in the 2001 Update***

10. The GFS data for 1998-99 will become available later in 2000. If they are of reasonable quality, we propose to replace the present estimates for 1998-99 with actual data from GFS in the 2001 Update. This would conform with normal Commission practice.

**TREATMENT OF SUPERANNUATION PAYMENTS**

11. Discussion Paper CGC 99/2 of September 1999 advised the States that:

The accrual data [for superannuation for 1998-99] remain of uncertain quality and not all States will report on this basis. ... A cash standard budget for the category will continue to be used until the next review.

12. Several States made very large payments in 1998-99 that would, under normal methods, have been included in the superannuation category. New South Wales made a payment of \$3.3 billion, Victoria \$2.6 billion and Western Australia \$300 million. Given the general unavailability of actual data for States for 1998-99, it is likely there were further abnormally large payments – in superannuation or other areas.

13. A similar situation arose in 1993-94 when Victoria made a \$1.4 billion payment to fund unfunded superannuation. In its 1995 Update, the Commission included that payment in the standard budget for 1993-94. In the 1999 Review, the Commission considered moving the Superannuation standard from a cash basis<sup>3</sup> to an accrual basis but decided not to do so because of the poor quality and comparability of accrual data.

14. In responding to advice of the Commission's proposed treatment of known large payments in this update, Victoria said that:

By including large one-off expenditure items, and encouraging jurisdictions to offer up additional one-off items, the Commission will produce distorted results that impact materially on relativities and grant shares. The underlying rationale for the use of multi-year relativities is precisely to avoid the distortions that may occur year to year, particularly in cash-based figures.

Victoria argued in general for the use of accrual rather than cash-based data. It said that if the Commission had to use an estimating approach, it should do so consistently and not bring in additional one-off items that would produce distorted results and impact materially on relativities and grant shares.

15. The terms of reference for this update require the Commission to base its assessments on the application of the same principles, the same items of revenue and government services and the same methods of assessment that were used to calculate the

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3 The Superannuation category is defined on a cash basis to include expenditures on the contributions of governments to superannuation funds or superannuation payments for those whose salaries are included in the standard budget, together with associated administrative expenditures.

per capita relativities provided in the Commission's 1999 Review Report, except where they specifically direct otherwise, as in the case of the tax reform changes, or to deal with later budgetary developments. In effect, they require us to apply the superannuation assessment method used in the 1999 Review and preclude the implementation of an accrual standard or accrual methods for this update.

16. We recognise that this approach does not sit well with the increasing adoption of accrual accounting by the States. Under an accrual approach, payments such as these would not be operating expenses and would not be included in the standard budget. In the 1999 Review, the Commission indicated that superannuation should be assessed on an accrual basis when it was satisfied with 'the quality and interstate comparability' of the accrual data. Those conditions do not exist for this update and, in any event as noted above, the terms of reference do not allow for a change in assessment method.<sup>4</sup>

17. As indicated above, because of the lack of actual data for 1998-99, we used estimation procedures for all States (except the ACT) to estimate all expenditure standards. Given that these large superannuation payments were known to have been made in 1998-99, the issue for this update was whether they should be included in the Superannuation standard for that year. Their inclusion would almost certainly have yielded a result closer to the actual outcome for 1998-99, but would have introduced inconsistency in the Commission's approach across categories.

18. We concluded that consistent with the methods used for all other categories, the 1998-99 standard for the Superannuation category should be estimated under the same approach. Our intention is that the actual payments be included when the estimations for 1998-99 are replaced by actual data. Unless directed otherwise in the terms of reference, we expect this to be in the 2001 Update.

## **HOW TAX REFORM AFFECTS THE COMMISSION'S TASK**

19. A key element of the *A New Tax System* (ANTS) package was the change in Commonwealth-State financial relations which culminated in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (the IGA), signed by Heads of Government in June 1999.

20. The important aspects of the IGA for the Commission's work in this update are that:

- (i) the pool of general revenue assistance to be distributed to the States in 2000-01 will increase markedly and comprise GST revenue grants and health care grants (financial assistance grants of the traditional kind will cease);

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<sup>4</sup> The inclusion of these types of cash payments is consistent with the existing definition of the Superannuation standard. Until such time as it is agreed that an accrual method should be implemented, the inclusion of these payments would support the achievement of fiscal equalisation over time.

- (ii) payments to the States of revenue associated with the safety net surcharge arrangements for alcohol, petroleum and tobacco (revenue replacement payments) will cease;
- (iii) States will reduce their gambling taxes to take account of the impact of the GST on gambling operators;
- (iv) States will abolish or reduce a number of their taxes; and
- (v) States will be responsible for a First Home Owners' Scheme and GST administration costs.

21. Two additional aspects of the IGA affect the calculations for 2000-01 and will have an impact on the Commission's work in the short term. They are:

- the Commonwealth has guaranteed that, in the transitional years following the introduction of the GST, each State's budgetary position will be no worse off than it would have been had the reforms not been implemented (clause 10 of the IGA); and
- in 2000-01 and 2001-02, States that acquire budget gains because of the changes are required to make those funds available for distribution to States that do not gain (clause 14 of the IGA).

### ***The Commonwealth Guarantee***

22. In the initial years after the introduction of the GST, it is not expected that the increase in Commonwealth funding to the States resulting from the GST revenue will be sufficient to fund the States' existing and additional expenditure responsibilities arising from the IGA, taking into account the reduced State tax revenue.

23. The practical effect of the Commonwealth guarantee is that a State is guaranteed a minimum amount for the duration of the transition period<sup>5</sup>. The IGA specifies that the Guaranteed Minimum Amount (GMA) for each State is to be calculated as equal to:

- (i) a State's FAG distribution — determined by applying the Commission's updated FAG relativities to the combined pool of financial assistance grants and health care grants that would have been available for distribution had the ANTS reforms not taken place; *plus*
- (ii) an estimated State budget impacts amount — to compensate the State for the net effect of its loss of revenue and increase in expenditure responsibilities under ANTS.

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<sup>5</sup> The transition period can be extended by regulation. It is likely to be different for different States. The intention is that for the life of the agreement, the transition period for a State will extend so long as the changed arrangements are to the detriment of its budget.

24. Thus, a State's GMA is determined by the relationship:

$$\begin{array}{lcl} \text{Guaranteed Minimum Amount} & \textit{equals} & \text{FAG Distribution} \\ & \textit{plus} & \text{Estimated State} \\ & & \text{Budget Impacts} \\ & & \text{Amount} \end{array}$$

25. In line with the IGA arrangements for the transitional period, a State will receive the larger of its GMA or its GST distribution — determined by applying the Commission's 2000 Update GST relativities to the combined pool of GST revenue grants and health care grants. If a State's GST distribution is less than its GMA, the difference is paid to the State in the form of a Transitional Assistance Payment<sup>6</sup>.

26. The Commonwealth and States have agreed that all States will be subject to the GMA in 2000-01, and their grants will therefore comprise:

$$\begin{array}{lcl} \text{Guaranteed Minimum Amount} & \textit{equals} & \text{GST Distribution} \\ & \textit{plus} & \text{Transitional} \\ & & \text{Assistance Payment} \end{array}$$

27. The relationships in paragraphs 24 and 26 can be combined. Doing so, and using the 2000-01 IGA estimates (the italicised figures below)<sup>7</sup> confirms that transitional assistance payments will be required in 2000-01. The transitional assistance payment for a State will depend on its assessed GST distribution, FAG distribution and estimated State budget impact.

$$\left[ \begin{array}{l} \text{GST} \\ \text{Distribution} \\ \\ (\$30.2 \textit{ b}) \end{array} + \begin{array}{l} \text{Transitional} \\ \text{Assistance} \\ \text{Payment} \\ \\ (\$2.4 \textit{ b}) \end{array} \right] = \text{GMA} = (\$32.6 \textit{ b}) = \left[ \begin{array}{l} \text{FAG} \\ \text{Distribution} \\ \\ (\$23.9 \textit{ b}) \end{array} + \begin{array}{l} \text{Estimated State} \\ \text{Budget Impacts} \\ \\ (\$8.7 \textit{ b}) \end{array} \right]$$

28. Box 2-1 provides a summary of the changed arrangements under the IGA.

<sup>6</sup> The IGA states that these payments will take the form of interest free loans and grants in 2000-01. The Commonwealth Treasury has advised that the structure of these payments has not yet been finalised.

<sup>7</sup> That is, the numbers estimated using the agreed *Methodology for Estimation of Components of the Guaranteed Minimum Amount* and provided to the Commission by the Commonwealth Treasury.

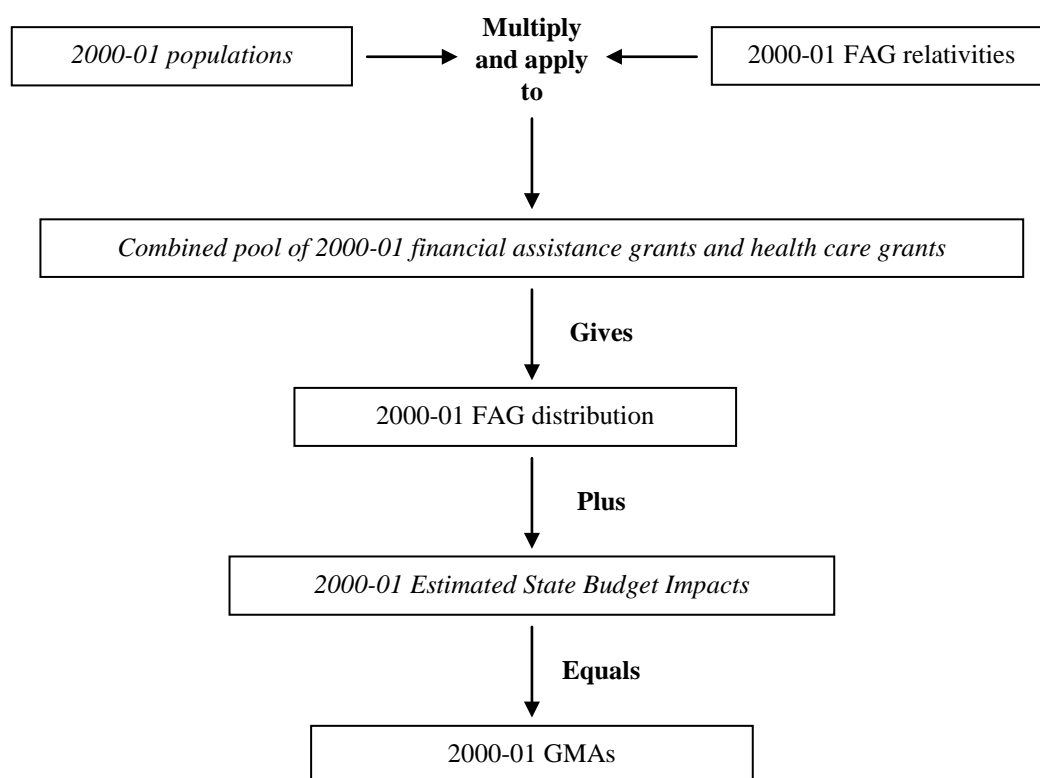
**Box 2-1: Guaranteed Minimum Amounts**

Under the *A New Tax System* (ANTS) package, there are to be major changes to Commonwealth-State financial arrangements. These include the States and Territories receiving all GST revenue and, in return, losing access to revenue replacement payments, abolishing a number of State taxes, reducing their gambling tax rates and assuming some additional expenditure responsibilities. These changes are specified in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (IGA) signed by the Heads of Government.

In the initial years, it is not expected that the GST revenue will be sufficient to fund the States' current expenditure and the new responsibilities they are assuming. Consequently, the Commonwealth has provided a guarantee that, in each of the transitional years following the introduction of the GST, no State's budgetary position will be worse off than it would have been had the reforms not been implemented (see clause 10 of the IGA). The practical effect of this guarantee is that, in the transitional period, a State will receive an amount equal to:

- (a) its FAG distribution — determined by applying the Commission's 2000 Update FAG relativities to the IGA estimated pool of financial assistance grants and health care grants that would have been available for distribution if the ANTS reforms had not taken place; *plus*
- (b) its estimated State budget impact — the amount required to compensate it for the net effect of its loss of revenue and increase in expenditure under ANTS.

The combined amount is known as the State's Guaranteed Minimum Amount (GMA). Schedule C of the IGA specifies how GMAs are to be calculated. The figures we have used were calculated using the *Methodology for Estimation of Components of the Guaranteed Minimum Amount* and provided to the Commission by the Commonwealth Treasury. The following diagram shows how the elements of the 2000-01 calculation are combined. Italics indicate that the relevant data were obtained from IGA estimates.



## GST RELATIVITY ASSESSMENTS

29. Under the IGA, the Commonwealth and the States developed a method for estimating the impact of each of the changes to State and Commonwealth responsibilities. The Commonwealth provided the Commission with:

- (i) a document, *Methodology for Estimation of Components of the Guaranteed Minimum Amount*; and
- (ii) the IGA estimates of those components for 2000-01, calculated using the method set out in that document and agreed to by all the parties.<sup>8</sup>

30. Our relativities for distributing a GST pool are based on the same framework and the same estimates for 2000-01 that the Commonwealth and the States agreed to under the IGA. This has involved changes to existing assessments, removal of a number of existing assessments and the introduction of several new assessments.

31. We reduced the category standards for:

- Gambling Taxation — because States have agreed to adjust their gambling taxes to take into account the impact of the GST on gambling operators;
- Other Taxes — because States have agreed to abolish bed taxes; and
- Contributions to Trading Enterprises — because of the revenue forgone by States from the abolition of Wholesale Sales Tax tax equivalent regimes.

32. We removed from the standard budget the three revenue replacement payment categories because these payments will cease.

33. We introduced a First Home Owners' Scheme and a GST Administration Costs category because States will assume responsibility for these functions. We also introduced a Subsidies – Petroleum Products and a Subsidies – Alcohol Products category to explicitly show States' continuing involvement in these areas.<sup>9</sup>

34. For some of these changes, financial data for our assessment period, (that is 1994-95 to 1998-99), were available. For others, financial data had to be estimated. Chapter 1 of the *Supporting Information* volume provides an explanation of how the standards were estimated in each case and the assessment methods we decided on for the new categories.

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8 Both the IGA and the *Methodology for Estimation of Components of the Guaranteed Minimum Amount* are reproduced as Attachment A in the volume of *Supporting Information* accompanying this report.

9 In the 1999 Review and in the 2000 FAG calculations, these subsidies are treated as offsets to the revenue replacement payment categories.

35. Apart from the reduction in standard for Gambling Taxation, Other Taxes and Contributions by Trading Enterprises, the financial standards used for the GST relativities are the same as those for the corresponding FAG assessments.

36. Apart from the new categories introduced for the GST relativities, the assessment methods used for the GST relativities are the same as those used for the corresponding categories in the FAG assessments.

37. ***Size of Pool.*** The Commonwealth Treasury provided the Commission with IGA estimates of the pool of funds that will be available in 2000-01. However, we base our relativities on assessments for each year in the period 1994-95 to 1998-99<sup>10</sup> and therefore required an estimate of what the size of the pools for GST relativities would have been in each of those years. After consultation with State and Commonwealth Treasuries, we decided to estimate the GST pools in the assessment period using the IGA estimates of GST revenues and FAGs for 2000-01. These estimates indicate that the GST revenues will be 35 per cent larger than traditional financial assistance grants would have been. We therefore estimated GST revenues for the assessment period by assuming they were also 35 per cent larger than the financial assistance grants that the States actually received.

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10 The Commission derives relativities for each year. The recommended relativities are the simple average of these.

## CHAPTER 3

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### THE RELATIVITIES AND OUTCOMES FOR 2000-01

1. This chapter presents:
  - (i) the two sets of per capita relativities assessed for 2000-01;
  - (ii) illustrative State grant outcomes for 2000-01;
  - (iii) comparisons of the distributions implied by the relativities; and
  - (iv) an estimate of the Transitional Assistance Payments (TAPs) for each State under the guarantee arrangements of the IGA.

### THE ASSESSED RELATIVITIES

2. Table 3-1 presents the GST relativities. Table 3-2 compares the relativities that were used to distribute financial assistance to the States in 1999-2000 with the FAG relativities assessed in this update. Chapter 4 explains how the GST relativities were derived. Chapter 5 explains the changes from the 1999-2000 relativities to the FAG relativities assessed for this update.

**Table 3-1** PER CAPITA GST RELATIVITIES – 2000 UPDATE

State	GST relativities
New South Wales	0.90913
Victoria	0.87049
Queensland	1.01830
Western Australia	0.98365
South Australia	1.18258
Tasmania	1.51091
Australian Capital Territory	1.11289
Northern Territory	4.16385

**Table 3-2 PER CAPITA FAG RELATIVITIES – 1999-2000 BUDGET AND 2000 UPDATE**

State	1999-2000 Budget	2000 Update
New South Wales	0.89948	0.89642
Victoria	0.86184	0.85780
Queensland	1.00687	1.01079
Western Australia	0.94793	0.92399
South Australia	1.20680	1.23481
Tasmania	1.60905	1.62565
Australian Capital Territory	1.10270	1.14522
Northern Territory	4.84429	4.85767

### STATE OUTCOMES FOR 2000-01

3. To illustrate the impact of the 2000 Update relativities on Commonwealth assistance to the States in 2000-01, IGA estimates were used to calculate the total amount of grants assumed to be available for distribution under each funding pool (GST and FAG).

4. In this update, the Commission has changed the FAG relativities from those used in the 1999-2000 budget. While the change in the relativities has had an effect on State outcomes for 2000-01, by far the larger effects result from the application of the agreed IGA methods and the use of IGA estimates for the size of the pool and the estimated budget impacts.

5. The IGA agreed estimates were developed on the basis of estimates available to the parties and may be subject to adjustment by the Ministerial Council in light of data availability. For that reason, in the remainder of this chapter, we use the terms 'likely distribution' and 'illustrative distribution' when presenting IGA agreed estimates.

#### *State Guaranteed Minimum Amounts for 2000-01*

6. Table 3-3 sets out our estimate of the GMAs for 2000-01. They are the agreed IGA estimates provided by the Commonwealth Treasury, modified by incorporating the Commission's 2000-01 FAG relativities into the calculations.

**Table 3-3** CALCULATION OF THE GUARANTEED MINIMUM AMOUNTS, 2000-01

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2000-01 FAG Distribution	7238.4	5087.7	4498.4	2185.3	2301.0	943.6	442.2	1194.2	23890.8
Estimated State Budget Impacts <sup>(a)</sup>	<i>2984.9</i>	<i>2000.2</i>	<i>1561.7</i>	<i>987.4</i>	<i>697.9</i>	<i>243.5</i>	<i>138.7</i>	<i>145.8</i>	<i>8760.2</i>
Estimated 2000-01 GMAs	10223.4	7087.9	6060.1	3172.7	2998.9	1187.1	580.9	1340.1	<i>32651.0</i>

(a) Agreed IGA estimates of the net effect for 2000-01 of the loss of State revenues and the introduction of new expenditure responsibilities under the tax reform arrangements.

Note: Figures in italics are IGA estimates.

### ***GST Distribution of GST Pool***

7. Table 3-4 compares the illustrative distributions of grants for 2000-01 obtained:

- (i) from the GMAs for each State, as shown in Table 3-3; and
- (ii) by applying the GST relativities to the IGA estimate of the combined pool of GST revenue grants and health care grants for 2000-01<sup>1</sup>.

**Table 3-4** COMPARISON OF GMAs WITH ILLUSTRATIVE 2000-01 GST DISTRIBUTION

Illustrative Distribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Estimated 2000-01 GMAs	10223.4	7087.9	6060.1	3172.7	2998.9	1187.1	580.9	1340.1	<i>32651.0</i>
2000-01 GST Distribution	<i>9283.7</i>	<i>6529.1</i>	<i>5731.0</i>	<i>2942.0</i>	<i>2786.8</i>	<i>1109.1</i>	<i>543.4</i>	<i>1294.6</i>	<i>30219.7</i>
Difference	<i>939.7</i>	<i>558.8</i>	<i>329.1</i>	<i>230.7</i>	<i>212.1</i>	<i>78.0</i>	<i>37.5</i>	<i>45.5</i>	<i>2431.3</i>

Note: Figures in italics are IGA estimates.

8. This shows that in 2000-01, the GMAs for all States will be greater than their shares of the GST pool. As discussed in Chapter 2, these GMAs are also equal to their GST shares plus Transitional Assistance Payments (TAPs).

### ***Transitional Assistance Payments in 2000-01***

9. Table 3-5 sets out the estimates of the TAPs (which are equal to the difference shown in Table 3-4). These payments are the difference between the State's illustrative 2000-01 GST distributions and their illustrative 2000-01 GMAs.

<sup>1</sup> This pool was derived from IGA estimates for 2000-01. The GST revenue grant estimate was \$24.2 billion and the health care grant estimate was \$6.0 billion.

**Table 3-5** ESTIMATE OF THE TRANSITIONAL ASSISTANCE PAYMENTS REQUIRED IN 2000-01

Illustrative Distribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Estimated 2000-01 TAPs	939.7	558.8	329.1	230.7	212.1	78.0	37.5	45.5	<i>2431.3</i>

Note: Figures in italics are IGA estimates.

10. Under the IGA arrangements for 2000-01, TAPs could be financed from:
- (i) the surplus that any State gains from the new arrangements (the figures shown in Table 3-4 suggest this will not happen);
  - (ii) the provision of interest free loans to the States by the Commonwealth<sup>2</sup>; and
  - (iii) the provision of grants to the States by the Commonwealth.

### *Likely State Outcomes for 2000-01*

11. Table 3-6 compares the actual 1999-2000 Budget distribution to the States with the distribution they are likely to receive in 2000-01 — their GMAs.

**Table 3-6** COMPARISON OF THE 1999-2000 BUDGET DISTRIBUTION AND THE LIKELY 2000-01 DISTRIBUTION OF GMAs

Distribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Estimated 2000-01 GMAs	10223.4	7087.9	6060.1	3172.7	2998.9	1187.1	580.9	1340.1	<i>32651.0</i>
1999-2000 Budget	6974.2	4910.1	4283.7	2142.9	2175.8	909.6	412.1	1135.3	22943.7
Difference	3249.2	2177.8	1776.4	1029.8	823.1	277.5	168.8	204.8	9707.3

Note: Figures in italics are IGA estimates.

12. The differences between the actual 1999-2000 distribution and the GMA distribution reflect:

- (i) changes in (FAG) relativities between the 1999 Review and the 2000 Update;
- (ii) the change in the size of the pool to which the relativities are to be applied (from the 1999-2000 FAG pool to the estimated 2000-01 FAG pool); and
- (iii) the estimated State budget impacts (that is, the IGA estimates of the changes in revenue and expenditure for each State in 2000-01).

<sup>2</sup> Under the IGA, any loans are to be repaid in quarterly instalments during 2001-02.

13. Table 3-7 indicates the importance of each of these three components.

**Table 3-7** COMPONENTS OF THE DIFFERENCE BETWEEN THE 1999-2000 BUDGET DISTRIBUTION AND THE ILLUSTRATIVE 2000-01 GUARANTEED MINIMUM AMOUNTS

Component	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Change in relativities	-22.8	-22.6	18.6	-56.0	52.8	9.9	16.5	3.6	0.0
Change in size of pool	287.1	200.1	196.0	98.4	72.4	24.1	13.6	55.3	947.1
Estimated State Budget Impacts	<i>2984.9</i>	<i>2000.2</i>	<i>1561.7</i>	<i>987.4</i>	<i>697.9</i>	<i>243.5</i>	<i>138.7</i>	<i>145.8</i>	<i>8760.2</i>
Total	3249.2	2177.8	1776.4	1029.8	823.1	277.5	168.8	204.8	9707.3

Note: Figures in italics are IGA estimates.

### CHANGES ARISING FROM THE COMMISSION'S WORK

14. As indicated above, the 2000-01 FAG distribution influences the States' GMAs (although it is not the main influence), and hence the actual outcome. For that reason, it is useful to compare the 2000-01 FAG distribution with the 1999-2000 Budget distribution.

15. Table 3-8 reproduces the budget distribution for 1999-2000. We refer to this distribution, which has been applied to a pool of \$22.9 billion, as a FAG distribution. Table 3-8 also sets out an illustrative distribution of grants for 2000-01 using the updated FAG relativities. This distribution was derived by applying the 2000 Update FAG relativities to an IGA estimate of the combined pool of traditional financial assistance and health care grants that would have been available for 2000-01 if the ANTS had not been adopted. Again, we can refer to this as a FAG distribution.

16. The table shows that all States would receive a larger outcome under the 2000-01 FAG distribution than they received in the previous year.

**Table 3-8** DIFFERENCE BETWEEN THE ILLUSTRATIVE 2000-01 FAG DISTRIBUTION AND THE 1999-2000 BUDGET DISTRIBUTION

Distribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Illustrative 2000-01 FAG	7238.4	5087.7	4498.4	2185.3	2301.0	943.6	442.2	1194.2	<i>23890.8</i>
1999-2000 Budget <sup>(a)</sup>	6974.2	4910.1	4283.7	2142.9	2175.8	909.6	412.1	1135.3	22943.7
Difference	264.2	177.6	214.7	42.4	125.2	34.0	30.1	58.9	947.1

(a) Distribution published in *Federal Financial Relations 1999-2000, Budget Paper No. 3, Table 12, p9.*

Note: Figures in italics are IGA estimates.

17. The changed distribution reflects:

- the increase in the size of the pool to which the relativities have been applied; and
- changes arising from the 2000 Update of the 1999 Review relativities.<sup>3</sup>

18. Table 3-9 shows how those two elements contribute to the total change. In general, the effect of the change in relativities is the smaller influence.

**Table 3-9** SOURCE OF THE CHANGE BETWEEN THE 1999-2000 BUDGET DISTRIBUTION AND THE ILLUSTRATIVE 2000-01 FAG DISTRIBUTION

Reason for change	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Change in size of pool	287.1	200.1	196.0	98.4	72.4	24.1	13.6	55.3	947.1
Change in relativities	-22.8	-22.6	18.6	-56.0	52.8	9.9	16.5	3.6	0.0
Total change	264.2	177.6	214.7	42.4	125.2	34.0	30.1	58.9	947.1

### RELATIVE IMPORTANCE OF THE CHANGES

19. Table 3-10 shows that, for 2000-01, changes in the pool (especially those generated by the tax reforms) and the estimated State budget impacts dwarf the change arising from implementation of the updated per capita relativities based on fiscal equalisation.

<sup>3</sup> There is a third, very small, change. For the 1999-2000 distribution the ABS estimate of 1999-2000 State populations was used. For the 2000-01 distribution, the 2000-01 population estimates were used.

**Table 3-10** SOURCE OF THE CHANGE BETWEEN THE 1999-2000 BUDGET DISTRIBUTION AND THE LIKELY 2000-01 BUDGET DISTRIBUTION

Reason for change	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
1999-2000 Budget Distribution	6974.2	4910.1	4283.7	2142.9	2175.8	909.6	412.1	1135.3	22943.7
Change in FAG Pool	287.1	200.1	196.0	98.4	72.4	24.1	13.6	55.3	947.1
Change in relativities from 1999-2000 Budget to 2000 Update	-22.8	-22.6	18.6	-56.0	52.8	9.9	16.5	3.6	0.0
Estimated State Budget Impacts	<i>2984.9</i>	<i>2000.2</i>	<i>1561.7</i>	<i>987.4</i>	<i>697.9</i>	<i>243.5</i>	<i>138.7</i>	<i>145.8</i>	<i>8760.2</i>
Likely 2000-01 Budget Distribution (GMAs)	10223.4	7087.9	6060.1	3172.7	2998.9	1187.1	580.9	1340.1	32651.0

Note: Figures in italics are IGA estimates.

## CHAPTER 4

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### THE GST RELATIVITIES

1. This chapter provides:
  - (i) an explanation of how the GST relativities were derived; and
  - (ii) an explanation of why the GST relativities and distribution differ from their FAG counterparts.

### THE DERIVATION OF THE GST RELATIVITIES

2. The terms of reference ask that, in calculating the GST relativities, the Commission take into account the IGA signed by the Heads of Government in June 1999. In Chapter 2, we listed aspects of the IGA that had implications for the Commission's work. They were that:

- (i) the pool of general revenue assistance to be distributed to the States in 2000-01 will increase markedly and comprise GST revenue grants and health care grants (financial assistance grants of the traditional kind will cease);
  - (ii) payments to the States of revenue associated with the safety net surcharge arrangements for alcohol, petroleum and tobacco (revenue replacement payments) will cease;
  - (iii) States will reduce their gambling taxes to take account of the impact of the GST on gambling operators;
  - (iv) States will abolish or reduce a number of their taxes; and
  - (v) States will be responsible for a First Home Owners' Scheme and GST administration costs.
3. In this chapter, we explain the effect of these changes on the relativities.

4. **Change in the size of the pool (of general revenue assistance).** The IGA estimates<sup>1</sup> of the 2000-01 GST pool (\$30.2 billion) and FAG pool (\$23.9 billion) suggest that the GST pool will be much larger.

5. Chapter 1 explained that the last step in the calculation of relativities is to divide a State's per capita requirement for assistance by the average per capita assistance available. For the calculation of the GST relativities, the increase in the size of the pool of available funds was reflected in the five years of the assessment period

6. For the same assessment of expenditure and revenue influences, dividing by a larger average per capita assistance figure will result in per capita relativities that are closer to one. As the GST pool is larger than the FAG pool, the average per capita assistance figure used for the GST relativity is greater than that used for the FAG relativity. Other things being equal, we would therefore expect the GST relativities to be closer to one. Although changes were made to assessments in the calculation of the GST relativities, the largest cause of change to the relativities was the increase in the size of the pool.

7. **Cessation of revenue replacement payments.** The Commission dealt with this change by removing the revenue replacement payments from the standard budget. This change had large positive effects on the relativities of Queensland and Western Australia because they had been assessed to have high capacities to raise revenue from revenue replacement payments. Victoria, on the other hand, had been assessed to have a low capacity and the effect on its relativities was negative.

8. **Adjustment to gambling taxes.** The IGA says that States will adjust their gambling taxation arrangements to take account of the impact of the GST on gambling operators. The Commission implemented this change by reducing the amount of gambling revenue in the standard budget. Following advice from the States, the reduction was estimated as one eleventh of the State gambling expenditures as published in *Australian Gambling Statistics*. This had most effect on New South Wales because of its high revenue raising capacity, and Queensland because of its low capacity.

9. **Abolished State taxes.** The IGA specifies that from 1 July 2000, State bed taxes would cease to be levied. The Commission implemented this change by removing the New South Wales and Northern Territory bed taxes from the standard budget. As the relevant category, Other Taxes, is assessed by the equal per capita method, this had no effect on State relativities.<sup>2</sup>

10. **Abolished Wholesale Sales Tax (WST).** Although the WST is a Commonwealth tax, its abolition from 1 July 2000 means that States will no longer be able to obtain revenue from WST tax equivalent regimes applying to their Public Trading Enterprises. The Commission implemented this change by removing from the standard budget an amount specified in the agreed methodology for calculating components of the GMA. As the relevant category, Contributions by Trading Enterprises, is assessed by the equal per capita method, this had no effect on State relativities.

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1 That is, the estimates calculated using the *Methodology for Estimation of Components of the Guaranteed Minimum Amount*, that have been provided to the Commission by the Commonwealth Treasury.

2 Because it does not give rise to needs, an EPC assessment has no effect on relativities.

11. **First Home Owners' Scheme.** Under the IGA, the States will be responsible for a First Home Owner's Scheme. The Commission implemented this change by introducing a new expenditure category into the standard budget. Since the new scheme will pay \$7000 to all eligible applicants, State expenditure was estimated by multiplying the number of new home buyers by \$7000. The Commission accepted that these estimated expenditures represented the likely costs that States would face in operating this scheme. As the difference in costs was due entirely to the numbers of new home buyers, an influence beyond State control, the Commission decided that this should be the basis of the assessment. This change had most effect (positively) on the relativity of Western Australia because it had the biggest proportion of new home buyers in its population.

12. **GST Administration Costs.** Under the IGA, the States will be responsible for the administration costs of collecting the GST. The Commission implemented this change by introducing a new expenditure category into the standard budget and estimating State expenditure using the agreed IGA estimate of GST administration costs for 2000-01. The category was assessed by the equal per capita method because it has been agreed that these costs would be apportioned on an EPC basis. The introduction of this category therefore had no effect on State relativities.

#### **WHY THE GST RELATIVITIES DIFFER FROM THE FAG RELATIVITIES**

13. The GST relativities differ from the FAG relativities because they are:

- (i) based on a different mix of revenue and expenditure responsibilities — the IGA excludes some revenue sources and introduces additional expenditure functions; and
- (ii) intended to apply to a different pool.

14. These changes are tax reform-related because they are a direct result of the Commission applying the changes agreed to by the Commonwealth and the States in the IGA.

15. Table 4-1 shows how the change in scope and the change in the size of the pool contributed to the total change between the illustrative 2000-01 FAG and GST distributions. The changes affect States in different ways because their costs of providing the new services differ, and because their revenue capacities in the tax areas that have been abolished or changed also differ.

**Table 4-1 GRANT SHARE EFFECTS OF MAJOR DIFFERENCES IN FAG AND GST ASSESSMENTS**

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
FAG Distribution	7238.4	5087.7	4498.4	2185.3	2301.0	943.6	442.2	1194.2	23890.8
<b>(a) Change in size of pool</b>	2135.1	1566.6	1178.9	626.3	495.1	155.2	102.4	69.2	6328.9
<b>(b) Change in revenue assessments</b>									
Gambling Taxation	11.9	4.2	-11.0	-2.0	-2.3	-2.4	3.1	-1.5	0.0
Revenue Replacement Payments – Tobacco	-39.5	-78.8	63.9	23.8	0.9	15.9	-5.6	19.3	0.0
Revenue Replacement Payments – Petroleum	-19.7	-24.7	-7.7	41.0	0.1	3.2	-0.9	8.7	0.0
Revenue Replacement Payments – Alcohol	7.3	-24.7	11.8	8.1	-6.7	-0.3	-0.2	4.7	0.0
Other Taxes <sup>(a)</sup>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contributions by PTEs <sup>(a)</sup>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total</b>	<b>-40.1</b>	<b>-124.0</b>	<b>57.1</b>	<b>70.9</b>	<b>-7.9</b>	<b>16.3</b>	<b>-3.6</b>	<b>31.2</b>	<b>0.0</b>
<b>(c) Change in expenditure assessments</b>									
First Home Owners' Scheme	-38.7	4.0	-5.4	50.4	-8.2	-5.1	3.2	-0.2	0.0
GST Administration Costs <sup>(a)</sup>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Subsidies – Petroleum Products <sup>(a)</sup>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Subsidies – Alcohol Products	-11.2	-5.3	2.1	9.0	6.9	-0.9	-0.8	0.3	0.0
<b>Total</b>	<b>-49.9</b>	<b>-1.4</b>	<b>-3.3</b>	<b>59.4</b>	<b>-1.3</b>	<b>-6.0</b>	<b>2.4</b>	<b>0.1</b>	<b>0.0</b>
GST distribution	9283.7	6529.1	5731.0	2942.0	2786.8	1109.1	543.4	1294.6	30219.7

(a) This category is assessed EPC and so has no grant share effect.

Note: Figures in italics are IGA estimates.

16. Table 4-1 shows that the biggest changes resulted from the increase in the size of the pool and the removal of revenue replacement payments.

17. Of the changed assessments, the removal of revenue replacement payments had the largest effect. Under the FAG assessments, States with high per capita consumption of petroleum, tobacco and alcohol products were assessed to have a high capacity to raise revenue from the relevant products and therefore required a lower than average share of assistance. Under the GST relativities, State capacities relating to the consumption of these products are removed and grant shares increased or decreased, depending on whether States had above or below average capacities. For example, the Northern Territory has the highest

per capita consumption of petroleum, tobacco and alcohol products. The removal of these categories reduced its revenue raising capacity and increased its grant. The effects on each State's grant of the removal of the revenue replacement payments are summarised in Table 4-1.

18. Western Australia has a high proportion of first home buyers in its population and this greater demand has a large effect on its share of assistance under the GST relativities.

19. Table 4-2 shows that the GST distribution comprises a State's:

- per capita share of the assistance available;
- adjustment because of its assessed cost of service provision ratio (lowest for Victoria, highest for the Northern Territory);
- adjustment because of its assessed revenue capacity (highest for New South Wales and Western Australia, lowest for South Australia and Tasmania); and
- adjustment because of its share of SPPs (highest for Western Australia and the Northern Territory, lowest for New South Wales, Victoria and Queensland).

**Table 4-2** DERIVATION OF THE ESTIMATED GST DISTRIBUTION, 2000-01

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
EPC share of pool	10211.2	7500.2	5627.8	2990.8	2356.5	734.0	488.3	310.9	<i>30219.7</i>
The effect of influences on expenditure requirements	-255.2	-1312.9	-214.1	556.8	40.0	160.7	-4.5	1029.1	0.0
The effect of influences on revenue capacities	-820.6	257.7	231.5	-398.3	400.2	221.0	65.0	43.6	0.0
The effect of the distribution of SPPs	148.1	85.6	86.2	-208.4	-9.6	-6.6	-5.3	-90.0	0.0
GST distribution	9283.7	6529.1	5731.0	2942.0	2786.8	1109.1	543.4	1294.6	<i>30219.7</i>

Note: Figures in italics are IGA estimates.

## CHAPTER 5

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### WHY THE 1999 REVIEW RELATIVITIES HAVE CHANGED

1. This chapter explains why the 2000 Update FAG relativities differ from those calculated in the 1999 Review and used for the distribution of general revenue assistance in 1999-2000. It discusses the main influences on per capita relativities and illustrates the main reasons for change in terms of their effects on grant shares.

### INFLUENCES ON RELATIVITIES

2. The equalisation principle is that:

State governments should receive funding from the Commonwealth such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.<sup>1</sup>

3. Given the diversity of the physical and demographic characteristics of the States, it is to be expected that they would need to spend different amounts per capita to provide the same level of services. A State may need to spend less than the Australian average if it had a lower proportion of the users of a service than average (for example, if the proportion of its population of school age were less than the national average) or a lower cost of service provision (for example, a less dispersed population). If a State needs to spend less than the Australian average to provide a standard level of services, then, all else being equal, it requires (and receives under equalisation principles) a lower per capita share of general revenue assistance.

4. Similarly, given the diversity of their economic characteristics, it is to be expected that States would raise different amounts of revenue per capita if they levied taxes and charges with the same coverage and rates. A State might have a high capacity to raise revenue because it has a stronger industrial or business sector, or a better endowment of natural resources than others.

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<sup>1</sup> Commonwealth Grants Commission, *Report on General Revenue Grant Relativities 1999, Volume 1, Main Report*, p4.

5. Thus, some States require more, and others require less, than an equal per capita share of general revenue assistance to provide the Australian average level of services.

6. The importance of the various influences differs among the States.<sup>2</sup> Revenue capacities are highest in Western Australia (principally because of its large mining industry) and lowest in Tasmania (because it has more small industries, low property values and low Gross State Product per capita). Costs of service provision are highest in the Northern Territory (because of diseconomies associated with the small scale on which many of its functions are provided, and the dispersion and the socio-demographic composition of its population), and lowest in Victoria (because its population is relatively highly concentrated and sufficiently large to enable it to achieve economies of scale).

### WHY HAVE THE FAG RELATIVITIES CHANGED?

7. In Chapter 3, we compared the grant distribution implied by the 2000 Update relativities with that implied by the 1999 Review FAG relativities. We said that the changed distribution arose because of:

- the increase in the size of the pool to which the relativities were applied; and
- changes in relativities from the 1999 Review to the 2000 Update.

8. This chapter deals with the changes in relativities. Table 5-1 shows the grant share effect of these changes. They arise from the normal update procedures

**Table 5-1** DIFFERENCE BETWEEN THE DISTRIBUTION IMPLIED BY THE 2000 UPDATE FAG RELATIVITIES AND THE 1999 REVIEW RELATIVITIES

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2000 Update	7238.4	5087.7	4498.4	2185.3	2301.0	943.6	442.2	1194.2	23890.8
1999 Review	7261.3	5110.2	4479.7	2241.3	2248.2	933.7	425.7	1190.6	23890.8
Difference	-22.8	-22.6	18.6	-56.0	52.8	9.9	16.5	3.6	0.0 <sup>(a)</sup>

(a) Amount redistributed amongst the States was \$101.4 million.

Note: Figures in italics are IGA estimates.

<sup>2</sup> We term these influences *disabilities*, which we define as: 'influences beyond a State's control that require it to spend more (or less) per capita than the Australian average to provide the average level of service; or to make a greater (or lesser) effort than the Australian average to raise the average amount of revenue per capita'.

9. In an update, the Commission is required by the terms of reference to calculate the relativities using the latest available data for a specified five year assessment period (1994-95 to 1998-99 in this update). Thus, it:

- revises data for the relevant assessment years, where necessary (1994-95 to 1997-98 — the years common to both the 1999 Review and the 2000 Update); and
- advances the five-year assessment period by substituting the calculations for the latest year of the assessment period (for example, 1998-99 in this update) for the oldest year used in the previous inquiry (1993-94 in this update).

10. Table 5-2 shows how each of these changes contributed to the total change in grants shown in Table 5-1. Advancing the assessment period had the larger effect.

**Table 5-2** 1999 AND 2000 FAG RELATIVITIES - RELATIVE IMPORTANCE OF REASONS FOR CHANGE

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total <sup>(a)</sup>
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Revising data	32.9	-11.3	-7.4	-13.5	6.3	0.1	-6.4	-0.6	39.3
Advancing the assessment period	-55.5	-11.1	26.1	-42.4	46.3	9.7	22.9	4.0	109.1
Total change	-22.8	-22.6	18.6	-56.0	52.8	9.9	16.5	3.6	101.4

(a) Amount redistributed.

11. Advancing the assessment period and revising data for the common years both result in changes in:

- (i) the financial standards for revenue and expenditure categories and SPPs which comprise the standard budget;
- (ii) the assessment of State revenue capacities and costs of service provision; and
- (iii) the distribution of SPPs.

### **Revising Data**

12. The Commission revises data when more recent data become available, when actual data become available to replace previous estimates, or when an error has been detected.

13. **Revisions to financial standards.** These resulted from the provision of amended data by the ABS or the States. Only very limited changes were made in this update.

14. **Revisions to assessment data.** In this update, revisions were made to a number of assessments including Payroll Tax, Financial Transaction Taxes and Primary Industry for 1994-95 to 1997-98 because the ABS provided upgraded State National Accounts data. Queensland's grant was reduced most by these changes, and South Australia's was increased most.

15. Revenue estimates for 1997-98 were replaced with real data in the Gambling Taxation, Insurance Taxation and Mining Revenue categories. The main impact of these changes was to decrease New South Wales' capacity and increase its grant (\$10.0 million) and increase Queensland's capacity and reduce its grant (-\$5.2 million).

16. Revisions also arose because of the Commission's practice of calculating some factors by averaging data for a number of years and using the resultant factor in each year of the assessment period. For example, the 1999 Review construction cost factor that was applied in all years was assessed using data for the period 1993-94 to 1997-98. In this inquiry we calculated this factor using data for the period 1994-95 to 1998-99. This approach produces changes in all years of the assessment period (1994-95 to 1998-99). The changes accounted for about \$23 million of the change in the New South Wales grant shown in Table 5-2 as being due to revising data. In reality, it is an updating effect.

17. The distribution of SPPs can also be revised if the Commonwealth provides corrected information or if the Commission decides (or is told in terms of reference) to reflect the situation which will apply in the application year. Some very minor changes were made in this update.

### ***Advancing the Assessment Period***

18. The relativities are based on a moving average of assessments for each of the last five financial years. In each update, a new year's data are introduced to replace the first year. In this inquiry, we have replaced 1993-94 financial standards and assessments with those for 1998-99 data.

19. **Financial standards.** Changes in the financial standards are the result of changes in the levels of revenue or expenditure in each category. They are affected by changes in the circumstances of the States and by decisions of governments to change their priorities in revenue raising and service provision. In this update, the Debt Charges standard reduced substantially because of State government decisions to repay large amounts of debt using the proceeds of asset sales. States assessed to have higher cost of service provision for debt charges would require a reduced share of assistance because of the reduction in State debt charges expenditure. The Community Health standard increased because of the increasing importance placed by the States on these services. States assessed to have a higher cost of service provision for community health would require an increased share of assistance because of the increase in State expenditure on this function.

20. **Assessments.** Changes in assessments of revenue raising capacities and costs of services reflect factors external to State policies, such as economic cycles and demographic changes.

21. State revenue capacity depends on the levels of economic activity and asset values that States can tax. Changes in State revenue capacities can be broadly captured by changes in such things as:

- (i) levels of employment and wages, which directly affect payroll tax receipts;
- (ii) land values, particularly of commercial and industrial land, which influence land revenue; and
- (iii) property market values and turnover, which affect revenues from stamp duty on conveyances.

Over the years 1993-94 to 1998-99, the revenue capacities of New South Wales and Western Australia grew more rapidly than the Australian average. Conversely, the revenue capacities of Queensland and South Australia grew more slowly.

22. Changes in the cost of service provision occur because of changes in a State's circumstances (excluding government policy initiatives as explained in Chapter 2). Changes in the cost of service provision arise from:

- (i) changes in the demand for services (for example, demand for educational services increases if a State's proportion of the population which is of school age increases); and
- (ii) changes in the average unit cost of providing those services (for example, costs increase if an increasing proportion of students are in upper secondary classes).

Over the years 1993-94 to 1998-99, the cost of providing services increased in New South Wales and the ACT more rapidly than the Australian average. Conversely, the cost of providing services grew more slowly in Queensland.

23. ***Distribution of SPPs.*** The distribution of SPPs can change markedly over time, particularly if there have been major changes to Commonwealth-State financial relations. In this inquiry, the only major change in SPPs was the increase to Western Australia's Grants in Lieu of Royalties associated with revenue sharing arrangements for North-West Shelf projects.

24. The outcome for any State will depend on the combined effect of all of the influences discussed above. Table 5-3 provides a summary of their effects.

**Table 5-3** 1999 REVIEW AND 2000 UPDATE FAG RELATIVITIES - RELATIVE IMPORTANCE OF REASONS FOR CHANGE

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total <sup>(a)</sup>
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
<b>Revisions</b>									
Financial standards	-5.8	-2.3	1.4	2.5	2.4	0.9	-0.8	1.8	8.9
Assessments	38.2	-9.3	-9.7	-15.3	3.9	-0.6	-5.6	-1.6	42.1
	:	:	:	:	:	:	:	:	:
Total	32.9	-11.3	-7.4	-13.5	6.3	0.1	-6.4	-0.6	39.3
<b>Advancing the Assessment Period</b>									
Financial standards	-50.4	10.8	9.0	-4.3	10.8	10.1	7.9	6.1	54.7
Revenue assessments	-25.9	-13.8	30.5	-20.3	30.0	-1.9	3.6	-2.2	64.0
Expenditure assessments	21.4	-6.4	-26.6	-0.3	-1.3	1.6	13.2	-1.6	36.1
SPPs	7.1	4.4	1.0	-16.7	0.8	0.8	0.7	1.8	16.7
	:	:	:	:	:	:	:	:	:
Total	-55.5	-11.1	26.1	-42.4	46.3	9.7	22.9	4.0	109.1
Total Change <sup>(b)</sup>	-22.8	-22.6	18.6	-56.0	52.8	9.9	16.5	3.6	101.4

(a) Amount redistributed.

(b) The numbers in this table do not add to the totals because each row represents a separate step in the analysis and was calculated independently. Interactions between the different steps have been ignored.

25. Attachment A provides an analysis of the major changes for each State. Further explanation of why the relativities have changed, including the full quantification of the changes, is provided in the *Supporting Information* volume.

## CHAPTER 6

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### THE SPECIAL CIRCUMSTANCES OF THE AUSTRALIAN CAPITAL TERRITORY

1. In the 1999 Review, the ACT received funding for three kinds of special circumstances:

- (i) ***National capital factors.*** Allowances were made to recognise that some costs in the ACT are higher because of Canberra's status as the national capital. They were assessed as disability factors because the Commission believed that they should be taken into account in the distribution of funds between States.
- (ii) ***A transitional allowance for Police.*** This allowance was paid from outside the general revenue grant pool to assist the ACT with costs incurred in the provision of police services. It was assessed outside the pool because this is a cost for which the Commonwealth, rather than the States, is responsible. This allowance will continue while the ACT does not have full control of the policies adopted, and thus of the costs incurred, in the provision of police services by the Australian Federal Police.
- (iii) ***Special fiscal needs.*** This funding, also provided from outside the general revenue grant pool, was equivalent to funding provided to the other States for functions outside the scope of the assessments. It is provided to the ACT with its general revenue grant because it is not provided by the normal means. When self-government was instituted, these payments were intended to be temporary, but no permanent arrangements have been introduced to enable their cessation.

2. The terms of reference for this update require us to undertake 'a separate assessment ... of the transitional allowances and special fiscal needs required by the Australian Capital Territory'. This chapter contains our response to that requirement. It also provides information on the effect of the continued inclusion of national capital factors in the relevant category assessments.

### ***National Capital Factors***

3. In the 1999 Review, national capital factors were assessed in the Education, Regulatory and Other Services, Administration of Justice, Public Safety and Emergency Services, Culture and Recreation, and Urban Transit categories. These assessments have been continued in this update and result in a redistribution of \$12.2 million to the ACT.

### ***Transitional Allowances***

4. In the 1999 Review, a transitional allowance for Police was assessed because the ACT has little effective control over the provision of police services. Allowances in a number of other functions were assessed in earlier inquiries but these have been phased out.

5. The allowance for the 1999 Review was calculated as the then current value of the difference between two estimated salary costs for a notional ACT police force based on the 1995-96 Australian average number of police per 100 000 people. The first applied actual ACT salary costs per police officer; and the second used Australian average salaries per officer, adjusted for some disabilities. The assessed allowance was \$8.5 million.

6. For the 2000 Update, the allowance was continued because the ACT still has little effective control over its police services. The 1999 assessment was adjusted by the movement in the Consumer Price Index (CPI), as foreshadowed in the 1999 Report, and assessed for the 2000 Update to be \$8.7 million. The inflation rate used was Treasury's estimate, excluding the effect of the GST.

7. As a result of the allowance for higher police expenditure, an allowance was made for consequential increases in superannuation and debt charges (a similar allowance was assessed in 1999). These amount to \$0.8 million, the same as in the 1999 Review. The total transitional allowances for this update are therefore \$9.5 million.

### ***Special Fiscal Needs***

8. Special fiscal needs take account of the differences between Commonwealth-ACT financial arrangements and those generally existing between the Commonwealth and the other States. In the 1999 Review, allowances were made for:

- family law matters; and
- corporate affairs compensation.

9. ***Family law matters.*** The other States receive identifiable and separate reimbursement from the Commonwealth for expenditure on Family Law Act matters dealt with in magistrates' courts or by welfare departments. Prior to self-government, the ACT's reimbursement was provided within its general revenue funding.

10. Since no other arrangements have been negotiated, we have continued to assess special fiscal needs for family law matters using actual expenditure data supplied by the ACT. An amount of \$212 000 was assessed for 2000-01, rounded to \$0.2 million.

11. **Corporate affairs compensation.** The ACT was excluded from the arrangements agreed between the Commonwealth and the other States for payments for revenue foregone following the establishment of the national scheme of companies regulations.

12. In the 1999 Review, these needs were estimated using expenditure from 1989-90, inflated to 1998-99 prices. We have continued this process because it is similar to that used by the Commonwealth to derive the payments to the States. Again, the CPI used was the Treasury estimate, excluding the effect of the GST.

13. The amount assessed for 2000-01 is \$3.8 million.

**Summary**

14. Table 6-1 summarises the assessed transitional allowances and special fiscal needs for 2000-01 and compares them with those assessed for 1999-2000.

**Table 6-1** TRANSITIONAL ALLOWANCES AND SPECIAL FISCAL NEEDS

	1999-2000	2000-01
	\$m	\$m
<b>Transitional Allowances</b>		
Police	9.3	9.5
<b>Special Fiscal Needs</b>		
Family law matters	0.2	0.2
Corporate affairs	3.7	3.8
<b>Total</b>	13.2	13.5

## ATTACHMENT A

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### MAIN CHANGES IN THE FAG DISTRIBUTIONS

1. Chapter 5 explained that, in this update, changes in the relativities were brought about because the five year average on which they were based was moved forward one year and some of the data in the years common to this and the previous inquiry were revised. Thus, the changes were:

- (i) 1998-99 **revenue capacities** replaced 1993-94 capacities;
- (ii) 1998-99 **costs of service provision** replaced 1993-94 costs;
- (iii) the 1998-99 distribution of **SPPs** replaced the 1993-94 distribution;
- (iv) the 1998-99 **financial standards** replaced those for 1993-94; and
- (v) some of the data used to derive financial standards, revenue capacities, costs of service provision and the distribution of SPPs in the 1999 Review for the years 1994-95 to 1997-98 were revised (**revisions to data**).

Chapter 5 also explained that the outcome for any State depended on the combined effect of all of these influences.

2. Table A-1 illustrates the main changes in grants<sup>1</sup> that would have occurred in this update if the FAG relativities had been applied. It shows that:

- changes in revenue capacities had the largest impact on the grants of Victoria, Queensland, Western Australia and South Australia;
- changes in the cost of providing services had the largest impact on the grant required by the ACT; and
- changes in financial standards had the largest impact on the grants required by New South Wales, Tasmania and the Northern Territory.

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<sup>1</sup> Changes in grants in this attachment are used to illustrate the changes in State requirements for financial assistance from the Commonwealth, distributed on an equalisation basis.

Table A-1 also shows that revisions to data had a major impact on the New South Wales grant and changes in the distribution of SPPs had a large impact on Western Australia's grant.

**Table A-1** REASONS FOR CHANGE IN IMPLIED STATE GRANTS – 1999 AND 2000 FAG RELATIVITIES

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total <sup>(a)</sup>
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Revenue capacities	-25.9	-13.8	30.5	-20.3	30.0	-1.9	3.6	-2.2	64.0
Costs of service provision	21.4	-6.4	-26.6	-0.3	-1.3	1.6	13.2	-1.6	36.1
SPPs	7.1	4.4	1.0	-16.7	0.8	0.8	0.7	1.8	16.7
Financial standards	-50.4	10.8	9.0	-4.3	10.8	10.1	7.9	6.1	54.7
Revisions to data	32.9	-11.3	-7.4	-13.5	6.3	0.1	-6.4	-0.6	39.3
	:	:	:	:	:	:	:	:	:
Total <sup>(b)</sup>	-22.8	-22.6	18.6	-56.0	52.8	9.9	16.5	3.6	101.4

(a) Amount redistributed.

(b) The numbers in this table do not add to the totals because the grant changes for each line were calculated independently and interactions have been ignored.

3. Table A-2 presents the differential growth rates of selected indicators for the States from 1993-94 to 1998-99. It shows some of the influences reflected in the changes to the assessments of revenue capacities and the cost of service provision.

**Table A-2** CHANGE IN SELECTED INDICATORS, 1993-94 TO 1998-99

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	%	%	%	%	%	%	%	%	%
State final demand	27.9	28.4	25.3	25.0	20.9	15.5	15.6	47.3	26.3
Housing investment	43.0	52.9	-11.7	16.3	-1.9	-28.7	-34.5	123.0	23.7
Established house index (Capital cities only)	26.7	33.2	2.2	13.6	4.6	0.6	-4.6	24.3	19.5
Commercial & industrial land values	16.0	27.2	20.6	66.7	0.2	4.4	-9.6	58.1	22.6
Agricultural, forestry and fishing production	21.6	5.1	-2.9	9.6	53.9	23.6	73.6	4.0	13.2
Mining <sup>(a)</sup>	13.2	1.8	23.2	22.8	5.1	2.9	23.0	29.3	20.6
Wages and salaries	30.9	28.0	32.2	24.8	17.5	24.6	31.2	39.5	28.7
Population	5.1	4.4	9.3	8.3	1.6	-0.4	2.4	10.4	5.6
Employment	11.2	11.4	16.4	14.9	2.8	0.5	2.6	25.8	11.6
Unemployment rate (percentage points)	-3.3	-4.1	-1.8	-1.9	-1.5	-1.6	-1.0	-3.1	-2.9
Government school enrolments	-3.3	-3.4	-4.5	-6.2	-6.4	0.0	-5.9	-4.6	-4.0
Non-government school enrolments	4.2	2.3	8.4	11.2	12.2	-2.5	1.1	13.2	5.4

(a) Value added for the mining industry, excluding offshore oil and gas extraction, and uranium. The change is for the period 1993-94 to 1997-98 because 1998-99 data are not yet available.

Source: Commonwealth Grants Commission, *General Revenue Grant Relativities 2000 Update, Supporting Information*, Attachment E.

### REASONS FOR CHANGE — BY STATE

4. The rest of this attachment examines, for each State, the main reasons for the changes in implied grant shares arising from the differences between the 1999 Review and 2000 Update FAG relativities. Further details are provided in Chapter 9 of the volume of *Supporting Information*. Because only the main changes are highlighted, they cannot be added to obtain the overall grant effect for the State.

## NEW SOUTH WALES

5. New South Wales would receive \$22.8 million less in grants if the 2000 Update relativities, rather than the 1999-2000 Budget relativities, were applied to the 2000-01 FAG pool.

6. The State's strong economic performance between 1993-94 and 1998-99 resulted in its revenue capacity increasing faster than the Australian average. This was offset somewhat by an increase in costs of service provision relative to the Australian average, particularly through higher construction costs. New South Wales also experienced higher demand for government education and increasing debt charges costs relative to other States.

7. **Revenue capacity.** The increased revenue capacity of New South Wales reduced its grant by \$25.9 million. In particular, higher asset prices and an increased share of Australia's share market activity resulted in higher revenue capacity in such areas as:

- (i) Stamp Duty on Shares. Share market activity is at an all time high and Sydney's share of that activity is growing. This reduced the State's grant (-\$16.6 million).
- (ii) Stamp Duty on Conveyances. A very high growth rate in the real estate market since 1993-94, in terms of both values and turnover, resulted in a reduction in the State's grant (-\$10.6 million).

8. **Costs of service provision.** Relative increases in the costs of services increased New South Wales grant by \$21.4 million. The main contributors were:

- (i) Debt Charges. More rapidly increasing construction costs in New South Wales resulted in a relative increase in the State's debt (and thus its debt charges). This increased its grant (\$11.0 million).
- (ii) Government Schools Education. A slower rate of movement of students from government to non-government schools increased the State's grant because of an increase in the relative proportion of its students in the higher cost government schools sector (\$8.5 million).

9. **Financial standards.** Changes in the revenue and expenditure financial standards reduced the New South Wales grant by \$50.4 million. The biggest change was in the Debt Charges category where the falling standard reflected the States' large repayments of debt. This reduced the New South Wales grant by \$25.3 million because, although it requires more debt than the Australian average, a lower average amount now applies.

10. **Revisions to data.** The grant for New South Wales increased by \$32.9 million because of revisions to data. The principal revisions occurred as a result of the receipt of the construction cost indexes for 1998-99 and the use of upgraded ABS National Accounts data in the assessments.

## VICTORIA

11. Victoria would receive \$22.6 million less in grants if the 2000 Update relativities, rather than the 1999-2000 Budget relativities, were applied to the 2000-01 FAG pool.

12. The Victorian economy has recovered from its low point of the early 1990s and its higher revenue capacity in recent years is reflected across many revenue sources. Although Victoria always has service provision costs well below the Australian average, its service provision costs fell further between 1993-94 and 1998-99.

13. **Revenue capacity.** Victoria's increased revenue capacity reduced its grant by \$13.8 million. Employment growth and higher house prices resulted in higher revenue capacity in such areas as:

- (i) Payroll Tax. Strong wages growth, particularly in relatively large companies (those above the taxable threshold), reduced Victoria's grant (-\$16.6 million).
- (ii) Stamp Duty on Conveyances. Increasing house values and rates of turnover have increased the value of dutiable transactions and reduced Victoria's grant (-\$16.1 million).

14. **Costs of service provision.** Victoria's grant fell by \$6.4 million, largely because of more rapidly increasing costs in other States. It resulted from small changes across many categories, some of which were offsetting. The bigger changes were:

- (i) Government Schools Education. A relatively smaller movement from government to non-government primary schools than other States kept Victoria's government primary school enrolments up and increased its grant (\$7.8 million). A relatively faster movement away in the government secondary sector reduced its grant (-\$5.6 million).
- (ii) Emergency Services and Public Safety. Victoria's need for emergency services expenditure decreased relative to the other States (for example, hailstorm damage in New South Wales). This reduced its grant (-\$2.0 million).
- (iii) Superannuation. A relative reduction in staffing costs in Victoria compared to other States reduced Victoria's grant (-\$2.0 million).

15. **Financial standards.** Changes in the revenue and expenditure financial standards increased Victoria's grant by \$10.8 million. The biggest change was in the Debt Charges category where the falling Australian average per capita expenditure reflected large repayments of States' debt. This increased Victoria's grant by \$11.8 million.

16. **Revisions to data.** Victoria's grant decreased by \$11.3 million because of revisions to data, the most important being the receipt of more recent data on construction cost indexes.

## QUEENSLAND

17. Queensland would receive \$18.6 million more in grants if the 2000 Update relativities, rather than the 1999-2000 Budget relativities, were applied to the 2000-01 FAG pool.

18. The slump in the housing sector has been the main contributor to Queensland's falling revenue raising capacity. This was offset somewhat by a fall in costs of service provision relative to the Australian average, particularly through relatively lower construction costs, and a relatively lower demand for some services.

19. **Revenue capacity.** The reduced revenue capacity of Queensland increased its grant by \$30.5 million. The decline in private housing investment since 1993-94 and the slowing of the State's economy resulted in lower relative revenue capacities in:

- (i) Stamp Duty on Conveyances. A slower than average growth in housing prices meant that the value of transactions was relatively low, increasing Queensland's grant (\$21.5 million).
- (ii) Land Revenue. The slower than average growth in commercial industrial land values increased Queensland's grant (\$2.4 million).
- (iii) Financial Transaction Taxes. Relatively lower economic activity increased the State's grant (\$4.9 million).

20. **Costs of service provision.** Queensland's relative costs of service provision decreased considerably, reducing its grant by \$26.6 million, although there were some offsetting movements. The main contributors were:

- (i) Debt Charges. Lower costs of providing services reduced Queensland's need for debt servicing relative to that of other States. This reduced the State's grant (-\$17.4 million).
- (ii) Government Primary Education. Queensland's share of enrolments in this sector rose, but not as fast as its population. The decline in enrolments per capita reduced its grant (-\$3.8 million).
- (iii) Primary Industry. A decline in the State's share of agriculture, forestry and fishing production reduced its grant (-\$3.6 million).

21. **Financial standards.** Changes in the revenue and expenditure financial standards increased Queensland's share of assistance by \$9.0 million. The biggest change was in the Debt Charges category where the falling standard reflected large repayments of States' debt. This increased Queensland's grant by \$13.6 million.

22. **Revisions to data.** Queensland's grant decreased by \$7.4 million because of revisions to data. The principal revisions occurred as a result of the use of revised ABS data in some revenue assessments and of the 1998-99 construction cost indexes.

## WESTERN AUSTRALIA

23. Western Australia would receive \$56.0 million less in grants if the 2000 Update relativities, rather than the 1999-2000 Budget relativities, were applied to the 2000-01 FAG pool.

24. Western Australia is generally facing more favourable economic conditions than it did in 1993-94. It has experienced sustained economic and high population growth, and has buoyant mining and housing sectors. Its high economic growth is reflected in increased revenue capacity. Its costs of service provision changed very little.

25. **Revenue capacity.** The increased revenue raising capacity reduced Western Australia's grant by \$20.3 million. Over the period 1993-94 to 1998-99, commercial and industrial land values grew 196 per cent faster than the Australian average and the value added of the mining sector grew 10 per cent faster, increasing capacity in such areas as:

- (i) Land Revenue. A faster than average increase in the value of commercial and industrial land reduced the State's grant (-\$14.1 million).
- (ii) Mining Revenue. The relatively fast growth in mining reduced Western Australia's grant (-\$6.0 million).

26. **Costs of service provision.** Overall, Western Australia's grant fell by only \$0.3 million because of changes in costs of service provision, but there were many offsetting changes. The bigger changes were:

- (i) Government Primary Education. Western Australia's share of enrolments rose more slowly than its population. The relative decline in enrolments per capita reduced the State's grant (-\$4.5 million).
- (ii) Non-government Primary Education. Western Australia experienced a relatively strong growth in demand for this service, increasing the State's grant (\$1.4 million).

27. **SPPs.** A major influence on Western Australia's grant was the increase in its Payments in Lieu of Royalties, which moved from \$48 million in 1993-94 to \$163 million in 1998-99. Western Australia's share of SPPs increased from 11.2 per cent in 1993-94 to 12.4 per cent in 1998-99 as a result, decreasing its grant (-\$16.7 million).

28. **Financial standards.** Changes in the revenue and expenditure financial standards decreased Western Australia's share of assistance by \$4.3 million. The biggest change was in mining where the booming mining industries of Queensland, Western Australia and the Northern Territory increased the standard, reducing Western Australia's grant (-\$11.8 million).

29. **Revisions to data.** Western Australia's grant decreased by \$13.5 million because of revisions to data. The largest revisions occurred in the Primary Industries assessment where revised National Accounts data were used, and in the construction cost factor, updated for the latest construction cost indexes.

## **SOUTH AUSTRALIA**

30. South Australia would receive \$52.8 million more in grants if the 2000 Update relativities, rather than the 1999-2000 Budget relativities, were applied to the 2000-01 FAG pool.

31. Over the period 1993-94 to 1998-99, the South Australian economy grew at a slower rate than most of the other States, reducing its relative revenue raising capacity. Costs of providing services changed little.

32. **Revenue capacity.** The fall in South Australia's revenue raising capacity increased its grant by \$30.0 million. A low housing investment rate, high unemployment and low population growth combined to reduce its revenue capacity in such areas as:

- (i) Payroll Tax. Slower growth in wages increased South Australia's grant (\$16.2 million).
- (ii) Land Revenue. The slow rate of growth in commercial and industrial land values increased South Australia's grant (\$4.3 million).
- (iii) Stamp Duty on Conveyances. The poor performance of the real estate sector over the period 1993-94 to 1998-99 dampened the value of transactions. This increased South Australia's grant (\$1.9 million).

33. **Costs of Service Provision.** The costs of service provision fell slightly in South Australia, reducing its grant by \$1.3 million. There were a large number of small offsetting changes, the larger ones being:

- (i) Primary Education. Relatively lower demand for government services reduced the State's grant (-\$3.8 million). This was partly offset by a relatively higher demand for non-government services which increased the State's grant (\$1.7 million).
- (ii) Primary Industry. A higher than average growth of agricultural production increased the demand for services to agricultural industries and, as a result, South Australia's grant (\$2.7 million). This was offset by the consequential increase in capacity to raise revenue from the sector, thereby, reducing the State's grant (-\$1.3 million).

34. **Financial standards.** Changes in the revenue and expenditure financial standards increased South Australia's share of assistance by \$10.8 million. The biggest change was in the Stamp Duty on Conveyances category (\$3.7 million), where the increasing standard caused by the growth of receipts in other States increased South Australia's grant.

35. **Revisions to data.** South Australia's grant increased by \$6.3 million because of revisions to data. Using the upgraded National Accounts data from ABS increased the State's grant.

## TASMANIA

36. Tasmania would receive \$9.9 million more in grants if the 2000 Update relativities, rather than the 1999-2000 Budget relativities, were applied to the 2000-01 FAG pool.

37. Since 1993-94, the Tasmanian economy has grown more slowly than other States and there has been a fall in population. Tasmania has the highest unemployment rate and, in constant prices, has had very little growth in retail turnover. Median house prices have been flat since the early 1990s and housing investment has declined. However, the Commonwealth-State arrangements relating to the replacement of States' revenues from petroleum and tobacco have been beneficial to the State's overall revenue capacity.

38. **Revenue capacity.** The overall change in revenue capacity reduced Tasmania's grant by \$1.9 million. This was the net result of increased revenue replacement payments and the decline in revenue raising capacity. The main changes were:

- (i) Stamp Duty on Conveyances. Relatively low real estate activity increased Tasmania's grant (\$2.0 million).
- (ii) Financial Transaction Taxes. The generally lower economic activity increased Tasmania's grant (\$1.4 million).
- (iii) Revenue Replacement Payments – Petroleum. A higher share of 1998-99 petroleum RRPs, compared to its share of 1993-94 State business franchise fees, reduced Tasmania's grant (-\$1.0 million).
- (iv) Revenue Replacement Payments – Tobacco. A higher share of 1998-99 tobacco RRPs, compared to its share of 1993-94 State business franchise fees, reduced Tasmania's grant (-\$2.9 million).

39. **Costs of service provision.** Tasmania's cost of service provision increased only slightly, increasing its grant by \$1.6 million. This was the result of very small increases spread across a large number of categories. The biggest changes were:

- (i) Government Secondary Education. Tasmania experienced much less movement from the government schools sectors than other States. Consequently, the demand for this service increased relative to the other States, producing an increase in the State's grant (\$2.9 million).
- (ii) Debt Charges. Lower costs of providing services reduced Tasmania's need for debt relative to that of other States. This reduced the State's grant (-\$1.3 million).

40. **Financial standards.** Changes in the revenue and expenditure financial standards increased Tasmania's grant by \$10.1 million. The change occurred across a number of categories, increasing Tasmania's grant by less than \$2 million in each case (Stamp Duty on Conveyances: \$1.8 million; Payroll Tax: \$1.7 million; Land Revenue: \$1.4 million; and Other General Public Services: \$1.1 million).

## **AUSTRALIAN CAPITAL TERRITORY**

41. The ACT would receive \$16.5 million more in grants if the 2000 Update relativities, rather than the 1999-2000 Budget relativities, were applied to the 2000-01 FAG pool.

42. Since 1993-94, the ACT economy has grown at a slower rate than the Australian average and its relative revenue capacity has declined. Its costs of providing services has increased, largely as it assumes greater responsibility for State-like levels of superannuation liabilities and debt, which were negligible at the time of self-government.

43. **Revenue capacity.** The reduced revenue capacity of the ACT increased its grant by \$3.6 million. In particular, housing investment declined by 34 per cent over the period compared with the Australian average, with housing prices declining by 4.6 per cent and commercial and industrial land values by almost 10 per cent. These resulted in lower revenues capacity in:

- (i) Stamp Duty on Conveyances. The fall in real estate activity compared to other States increased the ACT's grant (\$2.6 million).
- (ii) Land Revenue. The fall in the relative value of commercial and industrial land values increased the ACT's grant (\$2.4 million).

44. **Costs of service provision.** The ACT's cost of service provision increased in this update, increasing its grant by \$13.2 million. This was largely due to changes in two categories:

- (i) Debt Charges. The 15-year phase-in arrangements operating in the Debt Charges assessment for the ACT increased its grant. At the time of self-government, the ACT had very little debt and the Commission's assessment allows it to move to State-like levels of debt over time (\$7.3 million).
- (ii) Superannuation. The effect of similar 15-year phase-in arrangements operating for the ACT's assessment for superannuation expenditure also increased the grant (\$6.3 million).

45. **Financial standards.** Changes in the revenue and expenditure financial standards increased the ACT's share of assistance by \$7.9 million. The biggest change was in the Debt Charges category where the falling standard reflected large repayments of States' debt. This increased the ACT's grant by \$5.8 million.

46. **Revisions to data.** The ACT's grant decreased by \$6.4 million because of revisions to data. The main revisions were to the construction costs factors and revenue capacities based on revised ABS National Accounts data.

## NORTHERN TERRITORY

47. The Northern Territory would receive \$3.6 million more in grants if the 2000 Update relativities, rather than the 1999-2000 Budget relativities, were applied to the 2000-01 FAG pool.

48. Since 1993-94, the Northern Territory economy has experienced the fastest economic growth of any State. The resulting increase in revenue rising capacity was more than offset by the increase in the Territory's grant caused by changes in State expenditure patterns.

49. **Revenue capacity.** The increased revenue capacity of the Northern Territory reduced its grant by \$2.2 million. In particular, its high population growth, the highest employment growth, the lowest unemployment rate and very high growth in housing activity resulted in higher revenue capacity in such areas as:

- (i) Payroll Tax. Relatively faster growth in wages has reduced the Territory's grant (-\$1.2 million).
- (ii) Financial Transaction Taxes. Relatively faster economic growth reduced the Northern Territory's grant (-\$1.2 million).
- (iii) Land Revenue. Higher industrial and commercial land values reduced the Territory's grant (-\$0.9 million).

50. **Costs of service provision.** The cost of providing services in the Northern Territory changed very little in this update, decreasing its grant by \$1.6 million. The largest change was in Debt Charges (\$1.2 million) but this was more than offset by small falls in costs of providing services in a range of categories which each reduced the Northern Territory's grant by less than \$0.6 million (including Aboriginal Community Services, Government Primary Education, Vocational Education and Training and Hospitals).

51. **Financial standards.** Changes in expenditure financial standards increased the Northern Territory's grant by \$6.1 million. The biggest change was in the Community Health category where the standard is increasing because States are providing more of these services, and the Northern Territory's costs of providing services of this type are very high, almost 4 times the Australian average.